

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20628-0001

Annual Compliance Report

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Docket No. ACR2015

**REPLY COMMENTS OF THE ASSOCIATION FOR POSTAL COMMERCE
(February 12, 2016)**

Pursuant to Order No. 3027, the Association for Postal Commerce (“PostCom”) submits these reply comments on the Annual Compliance Report (“ACR”) for Fiscal Year 2015 filed by the United States Postal Service (“Postal Service”) on December 29, 2015. These reply comments build on PostCom’s initial comments on the ACR and incorporate information that the Postal Service has provided in information request responses since those comments were filed.

I. The Comments and the Postal Service Data Responses Highlight the Postal Service’s Struggles to Manage Costs Associated with Standard Mail Flats

The comments of the Public Representative reinforce and amplify the perspective provided by PostCom on the struggles of the Postal Service in managing costs associated with Standard Mail Flats. As PostCom explained in its initial comments, the Postal Service continues to take actions, and to engage in pricing practices, that decrease efficiencies in the processing and delivery of Standard Mail Flats, a point echoed by the Public Representative in his comments on the ACR. In particular, the Public Representative notes that the “financial condition of Standard Mail Flats has worsened”¹ and highlights the Commission’s concern, expressed in the 2014 Annual Compliance Determination (“ACD”), regarding the “Postal Service’s inability to quantify the cost savings of its initiatives to reduce costs for flat-shaped mail.”² The Public Representative notes further the Commission’s admonition to the Postal

¹ Public Representative Comments at 30.

² *Id.* at 33 (citing FY 2014 Annual Compliance Determination at 48).

Service to “take further action concerning its cost reduction initiatives for flat-shaped mail.”³

The Public Representative concludes that the Postal Service has not done what it was required to do to either contain costs, or to report adequately on its cost containment efforts, stating:

Based on analysis of the information presented in the FY 2015 ACR, the Public Representative cannot conclude that the Postal Service followed the Commission’s directives. Although the Postal Service gives a detailed description of the operational initiatives that took place in FY 2015, it admits its inability to provide any estimate of the resulting financial impacts.⁴

PostCom continues to urge the Postal Service to address these issues by making more efficient use of its existing resources, and by adopting more efficient pricing mechanisms that leverage fully the capabilities of the mailing industry to ensure that service can be provided at the lowest possible cost. As PostCom explained in its initial comments, much can be done to increase the efficiency of the Postal Service in the processing of Standard Mail Flats, and to avoid unnecessary and harmful rate increases. PostCom urges the Commission to focus on these issues, and to work with the Postal Service to drive the necessary operational changes.

II. The Comments Reinforce Concerns Regarding the Postal Service’s Ability to Accurately Measure and Comply With Applicable Service Standards

The Public Representative also highlights the downward trends in the Postal Service’s compliance with service standards. The Public Representative notes that within Standard Mail, “only High Density and Saturation Letters, and Parcels, exceeded service performance targets” and that “every Standard Mail service performance score, except for Carrier Route (which in any event was below target), was lower in FY 2015, then in FY 2014.”⁵

In the Commission’s proceeding on service performance measurement data, PostCom noted that the measurement of compliance with service standards is not always accurate because

³ *Id.*

⁴ *Id.* at 33.

⁵ Public Representative Comments at 4.

the Postal Service's business rules, particularly those around Start-the-Clock and Stop-the-Clock practices, do not facilitate accurate calculations. For example, the clock for mail from Detached Mail Units ("DMUs") should start when postal transportation leaves the mailer DMU, but the Postal Service does not start the clock until the truck arrives at the postal facility. Similarly, the start time for mail drop shipped to a destination sectional center facility ("DSCF") should be the time that a truck arrives at a postal facility to unload, but there currently is no accurate measurement of that arrival time.

The FY 2015 ACR, and the Public Representative's comments, highlight that even with the lack of precision and the unnecessary extra time built into the existing business rules for measuring compliance with applicable service standards, the Postal Service struggles to meet its service standard targets. As PostCom has emphasized in past filings, reliable, predictable, and consistent delivery service, within the parameters of the service standards, is a critical part of ensuring that customers continue to use the Postal Service, and ultimately to ensuring that mail remains a viable, low cost communication channel. Mail not delivered within its service standard is ultimately harmful to mailers, who face unhappy customers and potential lost revenue, and prompts them to look for alternative means of communicating with customers. PostCom urges the Commission to continue to work with the Postal Service on improving the measurement of service standard compliance, and on doing a better job of meeting its crucial service standard targets.

III. The Commission Should Reject Price Increases for Standard Mail Flats, and Should be Cautious About Reducing Workshare Discounts

ValPak argues for increases in prices for Standard Mail Flats in order to address the cost coverage issues highlighted above. The dramatic price increases that ValPak appears to be advocating are entirely unwarranted, for at least two reasons. First, as PostCom outlined in its

initial comments, and highlights again above, the substantial inefficiencies in the manner in which the Postal Service processes Standard Mail are not only identifiable, but – PostCom believes – correctible as well. It is possible to increase Postal Service efficiency in the processing of Standard Mail, particularly if the Postal Service were to take important steps toward better leveraging the efforts of the mailing industry, and sending appropriate pricing signals regarding where and how mail is entered into the Postal Service network. It is premature to consider any dramatic price increases until these tools for improving efficient processing have been fully leveraged.

Furthermore, the price increase that ValPak seeks for Standard Mail Flats is unwarranted because it would contravene the core pricing objectives reflected in the Postal Accountability and Enhancement Act (“PAEA”). *See* 39 U.S.C. Section 3622. Among the core objectives of the PAEA are to “maximize incentives to reduce costs and increase efficiency” and to “create predictability and stability in rates.” These objectives necessarily color and inform efforts to ensure that each mail class bear the costs associated with the Postal Service’s processing and delivery of that class of mail. A rate increase of the type advocated by ValPak would cause a substantial amount of rate shock, contravening the goal of predictability and stability in postal rates. To allow such a rate increase would be particularly anomalous given the fact that the Postal Service should be able to achieve much of its cost coverage for Standard Mail Flats if it were to address the efficiency issues identified by PostCom in its initial comments. Indeed, PostCom submits that such a rate increase would contravene the directive in the PAEA to maximize incentives to reduce costs and increase efficiency. Accordingly, PostCom submits that the Commission should reject ValPak’s request for a rate hike for Standard Mail Flats.

Similarly, the Commission should be very cautious about reductions in reducing discounts for workshare passthroughs for various categories of Standard Mail, as proposed by the Public Representative. As PostCom has emphasized to the Commission in previous filings, the PAEA's requirement to ensure that only 100% of avoided costs are reflected in a workshare discount is applicable over a longer-term period, rather than a strict standard that must be adhered to each year. It is very important that the Commission ensure that such discounts not fall below 100% of avoided costs, since such a pricing approach is likely to lead to inefficient behavior on the part of the Postal Service (*i.e.*, the Postal Service doing work that could be performed better by lower-cost mailing companies). In light of the efficiency issues outlined above and in PostCom's initial comments, any practices or pricing approaches that decrease efficiencies should be avoided. Such an approach also contravenes the PAEA's directive that workshare discounts need not be reduced where a "reduction or elimination of the discount would impede the efficient operation of the Postal Service." 39 U.S.C. Section 3922(e)(2). PostCom therefore urges the Commission to exercise caution in the reduction of workshare discounts.

IV. USPS Responses to CHIR No. 7 Confirm the Need to Better Identify Root Causes of Cost Changes before Taking Drastic Remedial Action

As noted in PostCom's Initial Comments, PostCom submitted two motions to the Commission for issuance of information requests on various topics, focusing especially on volatility of costs and the impact of various cost-saving initiatives. The Chairman issued these requests on February 1, 2016, and the Postal Service provided responses on February 8, 2016.⁶ The Postal Service's responses, while at times informative, ultimately highlight the need for the

⁶ Responses of the United States Postal Service to Questions 1-15, 17-29 of Chairman's Information Requests No. 7 ("USPS Responses to CHIR No. 7").

Postal Service and Commission to better understand the factors that are truly driving cost increases in the postal system. Before the Commission directs the Postal Service to take specific action to increase cost coverages or align workshare discounts, it must direct the Postal Service to further explore these issues. Most importantly, the Postal Service and Commission must remain cognizant of the interrelationship between Postal Service operations and mailer behavior and work to understand how changes in the former can impact the latter, either positively or adversely in terms of generating Postal revenue. With that goal in mind, PostCom submits the following comments on the Postal Services responses.

A. The Postal Service Has Not Explained Cost Drivers

In CHIR No. 7, the Chairman asked the Postal Service to identify the primary factors driving a variety of cost increases. The Postal Service's answers only seem to confirm that the Postal Service does not understand the economic, market, or operational factors driving its cost increases. Repeatedly asked to explain these increases, the Postal Service reverts to explaining the arithmetic behind the increases without providing any insight into the real-world conditions or management decisions that are ultimately responsible. Many cost increases are attributed to changes in methodology, particularly with respect to the treatment of direct and indirect city carrier street time costs. Ultimately, the Postal Service's explanations do not provide sufficient information about the ultimate causes of the identified cost increases to support any type of remedial action.

Indeed, the explanations it does give are at times contradictory. For instance, in explaining the 5.7% increase in processing costs for First-Class Mail presort letters, the Postal Service points to a decline in DCBS incoming SCF/Primary and Managed Mail Processing

(“MMP”) productivities and further notes that “weight per piece rose by 2.6 percent.”⁷ In explaining the 2.75% increase in processing costs for Standard Mail Letters, by contrast, the Postal Service cites the same decline in DBCS productivities, but acknowledges that “weight per piece . . . declined by . . . 1.4 percent” in FY 2015.⁸ Because the Postal Service does not provide any information on how weight-per-piece impacts the processing costs of these products, it is impossible to reconcile these two statements. Would costs have increased further for SM Letters if the weight-per-piece had increased or remained steady? How much of a role did the increase in weight-per-piece play in increasing FCM presort letters costs vis-à-vis the decline in DCBS and MMP productivities? With the limited information provided by the Postal Service, one cannot identify the relative importance of these factors in increasing costs.

Even more importantly, the Postal Service does not provide any insight into *why* weight-per-piece changed for either product. Likewise, it fails to explain why DCBS and MMP productivities declined. This inability to reach the ultimate question pervades the Postal Service’s responses, and, indeed, suffuses the ACR. Unfortunately, these ultimate questions are the ones that should most concern the Postal Service and the Commission, as the answers to these questions will dictate what actions the Postal Service should take to improve its efficiency. To answer these questions, the Postal Service must develop a deeper understanding of its customers’ needs and capabilities—it must understand why they mail and how that impacts how they mail. Then, it can implement practices that provide additional incentives to use the mail (increasing revenue) and improve efficiency in ways that preserve the utility of mail as a business communications and advertising channel.

⁷ USPS Response to CHIR No. 7, Q. 1.

⁸ USPS Response to CHIR No. 7, Q. 4.

B. The Postal Service's Answers Highlight the Need for Greater Use of IMb Data in Costing

The responses to CHIR No. 7 also highlight the need for the Postal Service to continue developing the tools to replace IOCS sampling data with census-level data driven by the IMb. The Postal Service contends that many of the cost changes identified by PostCom and the Chairman are results of sampling variance.⁹ The Postal Service notes that these variances are particularly large where the overall costs in question are low (presumably because of low volumes in the particular cost segment). By using the IMb instead of sampling methods, the Postal Service could reduce or eliminate this variation. That is, the Postal Service should be able to use the IMb to develop more accurate mail flows and more precisely identify the volume of each type of mail handled at each point in the process. In turn, this would allow the Postal Service to more accurately attribute the costs associated with each process to types of mail and reduce year-to-year variability.

Reducing this variability is an important goal, even for smaller costs. It is impossible to rationally set prices or workshare discounts, or evaluate whether prices produce sufficient contribution and workshare discounts provide proper incentives, when reported costs change wildly from year to year. The Commission should therefore urge the Postal Service to work to reduce this variability by moving away from sampling methods of cost assessment wherever possible.

V. Conclusion

PostCom reiterates its contention in its Initial Comments that many of the cost increases shown in the FY 2015 ACR are a result of the inefficient use of Postal infrastructure and

⁹ See Response to 7-1 (FCM Presort), 7-4 (SM Letters), 7-15(a) (BPM flats in-office), 7-17(a) (HD/Saturation, Mail Processing and Window Service) and 7-17(b) (EDDM).

misaligned pricing incentives. Nothing in the initial comments provided by other parties or in the Postal Service's responses to information requests has dissuaded PostCom from this belief. PostCom requests that the Commission direct the Postal Service to continue to work closely with the mailing industry to develop processes and incentives that maximize efficiency for the Postal Service *and* the industry and encourage business to grow their use of mail.

Respectfully submitted,

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